U.S. House of Representatives
Committee on Transportation and Infrastructure
Washington, DC 20515

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June 11, 2008

SUMMARY OF SUBJECT MATTER

TO: Members of the Subcommittee on Coast Guard and Maritime Transportation

FROM: Subcommittee on Coast Guard and Maritime Transportation Staff

SUBJECT: Hearing on Rebuilding Vessels Under the Jones Act

PURPOSE OF HEARING

The Subcommittee on Coast Guard and Maritime Transportation will meet on Wednesday, June 11, 2008, at 10:00 a.m. to receive testimony on rebuilding vessels under the Jones Act.

BACKGROUND

Purpose of the Merchant Marine Act of 1920

Section 27 of the Merchant Marine Act of 1920, commonly referred to as the Jones Act and presently codified at 46 U.S.C. 55102(b), limits coastwise trade (trade along the coasts of the United States) to vessels that were built in and documented under the laws of the United States; such vessels must be owned by American citizens. This provision was written to preserve an adequate U.S. shipbuilding and ship-repair industry, which is essential to national defense.

The Second Proviso of the Jones Act

Prior to 1956, U.S. law did not prohibit vessels that were rebuilt abroad from operating in the domestic trades. In 1956, Congress enacted the Second Proviso to the Jones Act to provide additional assistance to the shipyards of the U.S. by excluding vessels rebuilt in foreign yards from the coastwise trades. The Act authorized the Secretary of the Treasury to set regulations to carry out the purposes of the Act.

Initially, the Second Proviso stated that a vessel of more than 500 gross tons otherwise entitled to engage in the coastwise trade permanently lost the right to engage in that trade when it was rebuilt outside the U.S. The Proviso originally required the owner of a vessel of more than 500 gross tons documented in the U.S. to submit information regarding the circumstances of the rebuilding to the Secretary of the Treasury when the vessel was rebuilt outside the U.S. The Second Proviso was amended several times and now applies to all vessels engaged in the coastwise trade, regardless of tonnage.

The Second Proviso did not define the term "rebuilt." Instead, it used a term that had been defined by the courts. Congressional reports cited with approval a Treasury Department Report memorandum which noted:

> The Supreme Court has adopted a definition of the term (which would be applicable), to the effect that a vessel is considered rebuilt if any considerable part of the hull of the vessel in its intact condition, without being broken up, is built upon.[1]

The Customs Service amended its regulations in 1957 to reflect the additions to the Second Proviso. The regulations stated a vessel would be considered "rebuilt" if "any considerable part of the hull in its intact condition without having been broken up is built upon or substantially altered."[2]

Shipping companies had at the time been circumventing the foreign rebuild ban by building complete sections of hulls, known as midbodies, in foreign countries, towing them to the U.S., and installing them in coastwise vessels. In 1960, Congress amended the Second Proviso "to close a loophole and enacted that vessels of foreign construction shall not be permitted to operate in the coastwise trades of the United States."[3] According to the accompanying Committee reports: "Shipbuilding officials in the country view with alarm the Customs ruling that foreign midbodies could be used in the rebuilding of domestic ships without forfeiture of coastwise privileges." The House and Senate Committees reported that the bill was "needed to close the above-mentioned loophole in the existing (1956) statute and to buttress our traditional national objectives affecting the coastwise trade and the shipbuilding industry."[4]

On October 6, 2006, the Second Proviso of the Jones Act was recodified by Public Law 109-304 as 46 U.S.C. 12101(a) and 12132(b) to conform to the understood policy, intent, and purpose of the Congress in the original enactments. It now reads:

> Section 12101
> (a) REBUILT IN THE UNITED STATES. -- In this chapter, a vessel is deemed to have been rebuilt in the United States only if the entire rebuilding, including the

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[1] This definition was found in *United States v. The Grace Meade*, 25 F. Cas. 1387 (E.D. Va. 1876) (No. 15,243), which decision was adopted by the Supreme Court in *New Bedford Dry Dock Co. v. Purdy (The Jack-O'Lantern)*, 258 U.S. 96 (1922).

[2] 22 Fed. Reg. 6380, 6381 (1957).

[3] H.R. Rep. No. 1887, 86th Cong. (2nd Sess. 1960). *See also* S. Rep. No. 1279, 86th Cong. (2d Sess. 1960) at 3.

[4] Id

construction of any major component of the hull or superstructure was done in the United States.

Section 12132
(b) REBUILT OUTSIDE THE UNITED STATES. -- A vessel eligible to engage in the coastwise trade and later rebuilt outside the United States may not thereafter engage in the coastwise trade.

Coast Guard Determinations

From 1956-1996, the Coast Guard made determinations regarding whether construction on an existing ship constituted a "rebuild" on a case-by-case basis. To address court cases that resulted from a lack of consistency, the Coast Guard initiated a rulemaking and subsequently amended their regulations to clarify standards for vessel rebuild determinations in 1996.

Prior to April 1996, the Coast Guard's foreign-rebuild regulation provided that a vessel is rebuilt when any considerable part of its hull or superstructure is built upon or substantially altered. In April 1996, the Coast Guard amended the Code of Federal Regulations to clarify the standard for determining when work on a vessel performed outside of the U.S. constitutes a foreign rebuild.

The new provisions were intended to assist vessel owners and operators in making better business decisions regarding work to be performed on their vessels. In the Notice of Proposed Rulemaking that preceded adoption of the new regulations, the Coast Guard stated,

> The [then existing] rebuilt standard has been criticized as too subjective to provide guidance to vessel owners, who often must make critical business planning decisions with the outcome of a potential rebuilt determination by the Coast Guard in mind. The proposed guidelines, if adopted, would establish clear upper and lower thresholds relevant to rebuilt determinations and would provide for greater certainty to vessel owners making business decisions regarding work to be performed on their vessels.

After the implementation of the regulations, the greater of the weights of the steel added or removed from the vessel became the only relevant factor in determining whether a project involved a considerable part of the hull or superstructure. As a result, the Coast Guard does not utilize any additional information other than the comparative steelweight involved in the project to determine whether construction on a vessel involves a considerable part of the vessel's hull or superstructure.

Under Title 46, Code of Federal Regulations, Section 67.177, a vessel is deemed to have been rebuilt in a foreign yard when any considerable part of its hull or superstructure is built upon or substantially altered outside of the United States. The Coast Guard determines whether a vessel is rebuilt if the following parameters apply:

> Regardless of its material of construction, a vessel is deemed rebuilt when a major component of the hull or superstructure not built in the United States is added to the vessel.

For a vessel of which the hull and superstructure is constructed of steel or aluminum—

(1) A vessel is deemed rebuilt when work performed on its hull or superstructure constitutes more than 10 percent of the vessel's steelweight, prior to the work, also known as discounted lightship weight.

(2) A vessel may be considered rebuilt when work performed on its hull or superstructure constitutes more than 7.5 percent but not more than 10 percent of the vessel's steelweight prior to the work.

(3) A vessel is not considered rebuilt when work performed on its hull or superstructure constitutes 7.5 percent or less of the vessel's steelweight prior to the work.

There is not a requirement to submit a request to the Coast Guard for a preliminary determination if the planned work in a foreign shipyard is less than 7.5 percent of the vessel's steelweight. However, the regulations require a vessel owner to submit the required information whenever a vessel is altered outside the U.S. and the actual work performed versus the planned work is determined to constitute more than 7.5 percent of the vessel's steelweight.

With respect to the information submitted to the Coast Guard by the owner, the vessel and its equipment are subject to forfeiture if the owner of the vessel knowingly falsifies or conceals a material fact, or knowingly makes a false statement or representation, about the documentation of the vessel or in applying for documentation of the vessel.

Coast Guard's Process for Letter Rulings

Many vessel owners provide the Coast Guard with the required written information on the type of work they propose to complete in a foreign shipyard. Based on the information and calculations provided by the ship owners, the Coast Guard issues a preliminary rebuilding determination that states whether or not the proposed work will constitute a foreign rebuild.

It is the Coast Guard's position that a final rebuild determination cannot be made until the foreign work is completed. Recently, federal district courts have determined the preliminary rebuild determination letter issued by the Coast Guard is preliminary and not final agency action. Final agency action is not issued until the work has been completed in a foreign shipyard and the company submits their required information to the Coast Guard for a decision as to whether or not they exceeded the regulatory limitations.

If a shipping company or shipyard becomes aware of another company's preliminary application for rebuilding determination, they are unable to obtain information that was submitted along with the application. It's the Coast Guard's practice to release the preliminary determination, but not any supporting information until there is final agency action in which a Certificate of Documentation is issued with a coastwise endorsement.

Since the information is not releasable and the process is not transparent, a shipping company or shipyard is not able to file a suit against another entity until the work in a foreign

shipyard is completed, since the Courts do not have jurisdiction until a final agency action is determined.

United States Customs and Border Protection also enforces the Jones Act. Their rulings and letter opinions are a matter of public record and are posted on the internet.

JONES ACT COURT CASES

American Hawaii Cruises (Plaintiff) v Samuel K. Skinner (Defendants) and S/S Monterey Limited Partnership (Defendant-Intervenor)

In 1987, Monterey Limited Partnership (MLP) converted the *S/S Monterey* from a rusting cargo ship into a modern, fully-equipped passenger liner with the intention of operating the ship on cruises among the Hawaiian Islands. It had been modified in the United States and Finland. MLP sought guidance from the Coast Guard as to whether or not the work completed in the foreign shipyard would constitute rebuilding. In August of 1988, the Coast Guard found that the *Monterey* had not been "rebuilt" abroad and was eligible for the domestic trade.

American Hawaii Cruises and American Maritime Officers sought judicial review of that determination by suing under the Administrative Procedure Act. American Hawaii Cruises contended that the vessel had been rebuilt abroad and that the Coast Guard's decisions were unlawful, an abuse of discretion, and unwarranted based on the facts of the case. They alleged the rebuilding work done in Finland saved the owners approximately $25 million and that the arrival of the vessel in the Hawaiian cruise market diverted passengers to the *Monterey* that would have otherwise utilized one of American Hawaii's cruise ships.

Judge Joyce Hens Green for the U.S. District Court for the District of Columbia found that (1) although the Coast Guard cited its "rebuild" regulation in its rulings, it did not decide the case under that standard; (2) unlike its regulatory definition, the test the Coast Guard articulated was not a "permissible construction" of the Second Proviso; (3) the language of the statute did not suggest the test being used by the Coast Guard; (4) the Coast Guard pointed to nothing in the legislative history of the Second Proviso that would support the interpretation now adopted; and (5) the test used by the Coast Guard failed to take into account the language of the Second Proviso requiring that all "major components" be built in the United States.[5]

The court stated the Coast Guard's need to create a "de minimis" exception to a rule that has no precise contours suggested the formulation the Coast Guard embraced was far from adequate. For those reasons, the Court concluded that the structural/non-structural test by the Coast Guard is not a permissible construction of the Second Proviso. (For this determination, the Coast Guard considered non-structural work to be mere cosmetic and aesthetic changes and structural work to be building upon or substantial alteration of a considerable part of the hull or superstructure.)

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[5] *American Hawaii Cruises v. Skinner*, 713 F. Supp. 452, 465-468 (D.D.C. 1989) ("*Monterey*").

Finding the Coast Guard's decision unexplained and therefore unfit for judicial review, the District Court remanded the matter to the Coast Guard for further proceedings consistent with the court's opinion, and dismissed the civil actions.

Shipbuilders Council of America (Plaintiffs) v US Department of Homeland Security (Defendants) and Seabulk Energy Transport, Inc (Intervenor Defendants)

On March 11, 2005, Seabulk Energy Transport, Inc., which owns the *Seabulk Trader*, a tank vessel built in the United States to carry petroleum products in the coastwise trade, requested a preliminary determination from the Coast Guard regarding whether proposed work in a Chinese shipyard on the *Seabulk Trader* would result in a determination (1) that the vessel was "rebuilt" in a foreign shipyard under the Second Proviso to the Jones Act and the applicable Code of Federal Regulations and (2) that the vessel had its segregated ballast tanks installed outside of the United States under the applicable Code of Federal Regulations.

The proposed work involved installing internal bulkheads, or an "inner hull" throughout the vessel's cargo block and reconfiguring the vessel's existing ballast tank system. If the work was completed in a U.S. shipyard, the work was estimated to be likely to cost $30 million; Seabulk paid approximately $5 million to have the vessel altered in China.

Under the Oil Pollution Act of 1990 (OPA 90), the *Seabulk Trader* would have been unable to transport petroleum in U.S. waters after 2011 unless it was equipped with a double hull. Seabulk retrofitted the vessel in a Chinese shipyard in 2006-2007. Before having the work performed, however, Seabulk submitted estimates of the quantity of steel that would be added to the *Seabulk Trader* along with technical drawings of the new internal bulkheads to the Coast Guard for approval. On May 20, 2005, the Coast Guard issued a preliminary determination that the proposed work would constitute neither a foreign rebuild nor a foreign installation of segregated ballast tanks.

On May 8, 2007, Seabulk informed the Coast Guard that the work on the *Seabulk Trader* had been completed and advised them that the final weight of the components added to the Seabulk Trader constituted 8.15 percent of the vessel's pre-work steelweight and that the new bulkheads did not extend into the foremost and aft-most wing cargo tanks as originally planned. The cargo tanks had instead been converted into the vessel's ballast tanks. In the same letter, Seabulk requested that the Coast Guard issue a certificate of documentation with a coastwise endorsement. The Coast Guard issued the certificate on May 9, 2007.

Due to the proposed double-hull retrofit and the actual work performed involving the reconfiguration of the Seabulk Trader's segregated ballast tanks, there are two sets of relevant statutes and regulations pertaining to this case, including those dealing with rebuilding and those dealing with installation of segregated ballast tanks. The reconfiguration of the *Seabulk Trader's* segregated ballast tanks could potentially constitute a violation of the Port and Tanker Safety Act of 1978, codified at 46 U.S.C. 3704.

Plaintiffs Position

The plaintiff in this case, the Shipbuilders Council of America, which is an association of U.S. shipyards, alleged that the work on the *Seabulk Trader* completed in China could and should have been performed in the United States. Additional plaintiffs Crowley Maritime Corp and Overseas Shipholding Group, which are ship owners and operators, alleged the savings that Seabulk could realize by having the double-hull retrofit performed in China gave the company an unfair competitive advantage over other Jones Act vessels.

The plaintiffs claimed that the Coast Guard's determinations in this case were arbitrary and capricious, an abuse of discretion, and contrary to law under 5 U.S.C. 706(2)(A). They requested that the Court remand the matter to the Coast Guard with instructions to revoke the vessel's coastwise endorsement.

The plaintiffs claim the Coast Guard looked only to the amount of steel that was to be added to the *Seabulk Trader*, which ignored both the specific modifications made to existing structures on the vessel and the amount of steel removed from the vessel. The plaintiffs challenged this approach, arguing that if all the work was aggregated, the total steel work performed in China amounted to at least 9.44 percent of the vessel's steelweight.

In May 2008, the plaintiffs argued in Court that since the market is competitive, Crowley, Overseas Shipholding Group and other operators of Jones Act compliant tank vessels have sustained combined lost revenues of at least $12 million due to the unlawful operation of the *Seabulk Trader.*

Defendant's position

Seabulk Energy Transport contends that the Coast Guard's rebuild determination was not arbitrary and capricious or otherwise contrary to law and that the rebuild determination is consistent with applicable statutes because it is consistent with existing regulations.

They also argue that the plaintiffs cannot challenge the validity of the foreign-rebuild regulation because the limitation period for such a challenge expired long ago and that the statute requiring segregated ballast tanks on coastwise vessels to be installed in the United States does not apply in the context of the foreign double-hull retrofit issue at hand.

Seabulk requested a motion for stay and requested that the *Seabulk Trader* be allowed to continue operating in the domestic trade.

Coast Guard's position

The Coast Guard argues there is no subject matter jurisdiction over plaintiffs' claim that they misapplied the Second Proviso to the Jones Act because the term "rebuilt" is so broad as to preclude any meaningful judicial review of its decision that the *Seabulk Trader* was not rebuilt foreign.

Court Decision

On April 24, 2008, Judge Leonie Brinkema of the U.S. District Court for the Eastern District of Virginia ordered that the civil action by Shipbuilders Council of America be remanded to the Coast Guard with directions for the service to revoke the coastwise endorsement of the *Seabulk Trader.*

The Court disagreed with the Coast Guard's position that the *Seabulk Trader's* inner hull was not a major component because it was not a separable component that would be added to the hull. The Court also disagreed with their observation that the inner hull was not a separable component because it was constructed by adding steel, which was then built upon steel piece-by-piece. The Court found that this position was not persuasive and that the separable/inseparable distinction had not foundation in statute or regulation. The Court stated the manner in which the component is added to the vessel, piece-by-piece or wholesale is irrelevant to whether the component is considered major.

The Court found that the Coast Guard's separable/inseparable distinction will lead to arbitrary applications of the Jones Act. Also, the Coast Guard's vague separable/inseparable distinction, which was used to grant *Seabulk Trader* a certificate of coastwise eligibility, is likewise unfaithful to the text, history and purpose for the Second Proviso. For those reasons, the Coast Guard's decision was found to be invalid and was remanded to the agency for further proceedings.

Shipbuilder's Council of America, Inc. (Plaintiffs) v. U.S. Department of Homeland Security (Defendants) and Matson Navigation Company, Inc (Intervenor-Defendant)

This case, brought by Pasha Hawaii Transport Lines, LLC and Shipbuilders Council of America, involves a vessel operated by the Matson line.

On June 15, 2004, Matson requested a preliminary rebuilding determination by the Coast Guard for three of its vessels, the M/V *Mokihana*, M/V *Mahimahi*, and the M/V *Manoa* to covert the vessels from container ships to roll-on-roll-off (RoRo) vessels.

The vessels were to be altered partially in China and partly in the U.S. Matson paid approximately $10 million for the work completed in China and approximately $30 million for the work completed in the U.S.

The Coast Guard responded to Matson on June 23, 2004, stating the proposed alterations to be performed in China amounted to 6.7 percent of the vessels' steelweight, which was below the 7.5 percent regulatory threshold. Based on this information, the Coast Guard determined that the work would not result in a finding that the vessels had been rebuilt in a foreign yard and thus would not result in the loss of coastwise privileges for these vessels. Matson was cautioned by the Coast Guard that the decision was a preliminary determination based upon the estimates provided.

Herbert Engineering Corporation, which designed the garage to be placed on the three vessels, submitted a letter to the Coast Guard on April 25, 2005, seeking a preliminary rebuild determination to confirm its understanding that certain proposed work would be considered "outfitting" and would not be included in the steelweight calculations. The Coast Guard responded on June 8, 2005, by stating that one of the proposed alternatives would not be considered outfitting

and would be included in the steelwork calculations, which would increase the steelweight above 6.7 percent.

On October 26, 2006, Matson advised the Coast Guard that it decided to no longer pursue the proposed rebuilds of the M/V *Mahimahi* and the M/V *Manoa.* Matson sought another preliminary rebuild determination for the *Mokihana* stating the steelwork performed in China amounted to 8.1 percent of the steelweight, within the 7.5 – 10 percent range. Approximately a week later, Matson withdrew its request for a preliminary rebuild determination for the *Mokihana.*

On October 27, 2006, Pasha Hawaii Transport Lines, LLC requested that the Coast Guard reconsider Matson's original preliminary rebuild determination, suggesting that the total replacement work on the vessel exceeded 10 percent of the vessel's steelweight and that the Coast Guard should issue a final determination that the vessel was being rebuilt and advise Matson that all work should be completed in a U.S. shipyard in order for the vessel to maintain a coastwise endorsement.

The Shipbuilders Council of America submitted a similar letter to the Coast Guard supporting Pasha's request on October 30, 2006. The Coast Guard denied the requests for reconsideration on November 2, 2006.

On November 16, 2006, Pasha Hawaii Transport Lines and the Shipbuilders Council of America filed a suit challenging the Coast Guard's preliminary rebuild determination and sought an order vacating the Coast Guard's determination as arbitrary, capricious, and an abuse of discretion; a declaration that the vessels will be rebuilt in a foreign yard if the proposed work was performed on them and thus would no longer be entitled to a coastwise endorsement; an injunction enjoining the Coast Guard from issuing Matson a coastwise endorsement if the proposed alterations were completed in China; and a declaration that the Coast Guard's implementation of its regulations is inconsistent with the Jones Act. Specifically, the plaintiffs argued that in conducting rebuild determinations, the Coast Guard must consider the project as a whole with both the steelweight added and removed from a vessel in a foreign shipyard.

On April 13, 2007, Matson informed the Coast Guard that the work in China had been completed on the *Mokihana* and that the modification project resulted in a change in the gross and net tonnage. In this letter, Matson only sought a registry endorsement of the Certificate of Documentation, not a coastwise endorsement, therefore forfeiting their ability to be a Jones Act vessel. The company stated it would seek a coastwise endorsement after the final phase of the project was completed in a U.S. shipyard and before the vessel re-entered the domestic trade. The final phase of work was scheduled to being around May 14, 2007 in an Alabama shipyard.

The remainder of the work was completed on the *Mokihana* in an Alabama shipyard and Matson requested a final rebuild determination from the Coast Guard on August 13, 2007.

The Coast Guard issued a final agency action letter on October 23, 2007, stating after consulting the Coast Guard's Naval Architecture Division, the *Mokihana* had not been rebuilt and was eligible for coastwise privileges.

The oral arguments between the plaintiffs and defendants for a Motion for Summary Judgment will be heard on June 20, 2008.

GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT) AND THE WORLD TRADE ORGANIZATION (WTO)

The General Agreement on Tariffs and Trade (GATT), signed in 1948, is a multilateral agreement regulating trade among about 150 countries. According to its preamble, the function of the GATT is the "substantial reduction of tariffs and other trade barriers and the elimination of preferences, on a reciprocal and mutually advantageous basis." The principal objective of GATT is to expand international trade by liberalizing trade so as to increase economic prosperity among all members.

GATT generally prohibits domestic manufacturing restrictions, such as the U.S. build requirement in the Jones Act. However, these domestic laws were grandfathered under the GATT as they were enacted on the date of the GATT agreement.

There is a concern that if Congress attempts to restrict the U.S. build/rebuild requirement by amending the Jones Act or directing the Coast Guard to amend their regulations to accomplish a certain set of standards, then there is a risk that the amendments will activate the GATT. If the issue is argued by other countries and the U.S. loses, the U.S. will be subject to trade sanctions until the U.S. build requirement of the Jones act is repealed.

PREVIOUS COMMITTEE ACTION

The Subcommittee on Coast Guard and Maritime Transportation has never previously convened a hearing on rebuilding vessels under the Jones Act.

WITNESSES

PANEL I

Rear Admiral James Watson, IV
United States Coast Guard
Director of Prevention Policy for Marine Safety, Security and Stewardship

Ms. Patricia J. Williams
United States Coast Guard
Director of the National Vessel Documentation Center

Panel II

Mr. John P. Love
Vice President
Pasha Hawaii Transport Lines LLC

Mr. Matthew Paxton
President
Shipbuilders Council of America

Mr. Michael G. Roberts
Partner
Venable LLP
on behalf of Crowley Maritime Corporation